

MPS

MARTIN PLACE SECURITIES

Australia's Boutique Resources Investment Firm

An Outlook for Resources

April 2009

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The year 2008 will go down in history as one of the most volatile years ever experienced in financial markets and for the Resources Sector in particular. Record high levels for US\$ prices in gold and oil, a clear transfer of the baton for basic industries from the West as the BRIC et al made/demanded/used more raw materials (except oil) and an extraordinary entry and then rushed exit by the hedge funds all came together within that single year. Stock market collapse. Inflation. Deflation. Unleveraging. Global Financial Crisis. Recession. Depression. US\$ swoon. US\$ surge. It sure was all happening!!

Because of the internet and a connected world as we have never seen before, the meltdown in 2009 was instantaneous and, well, global. Global deleveraging was the trend but it also must have included global destocking. Any purchasing manager in 2008 would probably have initially gleefully jumped at the lower prices to average down on inventories acquired at higher prices in 2007. However, as the year wore on and hedge funds continued to offer even more metals at lower prices again, the protective stop-loss points of these purchasers would have been heavily hit! Thereafter, the downturn in demand in the second half of 2008 would have resulted in many market participants reducing inventories drastically.

But what can we make of it all now?

The markets move more quickly than any analyst can interpret and the overall market has tens of millions of participants. And markets can give you an instantaneous view of what is really happening - if we can see it and interpret it!

Daily BHP Stock Price June 08 - April 09



As always, it is essential to watch the markets to let them tell you what is really happening. Newspapers are giving you lots of bad news at present but it is all history. The top resources analyst groups around the world can give you excellent analysis of recent data and also give you forecasts. These guys are mostly good, reliable and have fingers on the pulse but as we have always seen most will extend the existing trend. Often a more senior economist will also have a macro view strategy that overrides their observations as well. We want to know what will be happening tomorrow.

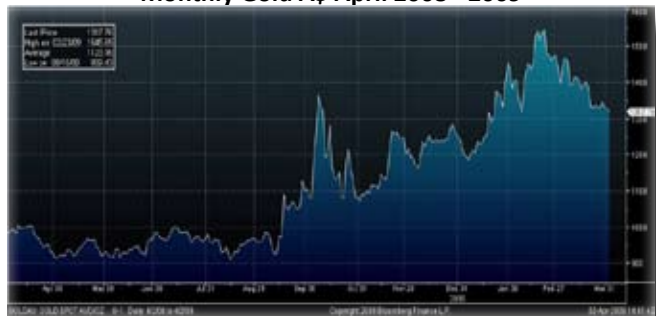
What we can now see in today's market is a remarkable panorama that shows that most resources companies and most commodities have not made new lows in 2009 whilst the major internationally recognized indices mostly have. Interestingly Shanghai and Hong Kong indices have not made new lows in

2009 either! BHP is up >55% against the US S&P500 in US\$. More importantly also, few quality smaller resources stocks have made new lows in 2009 and some have made new highs above 2008.

Certainly US\$ gold has moved up again and in 2009 gold has made a new high in almost every single currency except US\$, Yen and the Yuan. Many gold stocks around the world have rallied along with it.

Copper and oil are tantalizing us with signs of a recovery and the listed companies for these commodities are also looking good. Corporate activity centering around many coal seam gas stocks in Eastern Australia has seen many companies make new highs above 2008 levels. Some gold stocks have also made new highs in 2009 above the 2008 levels. Coal, iron ore and steel are still consolidating the massive run-ups in 2006-2008 so leave them to sort themselves out for a while yet.

Monthly Gold A\$ April 2008 - 2009



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So something else is happening and it probably doesn't include the D word just yet.

The major MPS theme for the past decade has really been the issue of supply. Not enough exploration has meant not enough major new discoveries have been made. At recent elevated consumption/production levels (and note that except primarily for aluminium and steel, most metal's consumption will be up in 2008 and 2009!) it is hard to see sufficient new capacity coming to offset declines in old and high cost mines.

This supply issue has not gone away and we can see global gold production will have its seventh consecutive annual decline this year. Certainly Peak Oil is still with us. Copper and also zinc may not be far away from similar outlooks.

The world is slowing as consumers around the world withdraw to rebuild balance sheets and unemployment is rising but worldwide government stimulus, particularly for infrastructure, and natural growth in the basic raw materials-consuming BRIC et al should keep the world ticking over. China seems ready to recover now, and note that China consumes almost three times as much copper as the US and produces almost five times as much steel.

So the overall global industry supply/demand position is still reasonably comfortable.

Where will the money flow?

But this brings us to the next major concept and perhaps the most important for us all to consider. The money flow side. Just think about the connections between US dollars, US Treasury Bonds, US\$ cash and world equity markets. These connections are likely to be the keys to all our futures.

The unexpected strong US\$ rally in 2008 caused much of the hedge fund deleveraging, just as the stock market meltdown caused a major flight to safety into US Treasury Bonds. These two big US currency and bond surges look as if they might now be turning down. We also saw equity markets falling as the US\$ rose against almost all currencies. But we also know that investor fear has left over US\$9trillion in US bank deposits and cash funds – this is equal to over 80% of the market cap of the top 6500+ stocks in the broad Wilshire 5000 Index – and earning less than 0.5%pa.

The astronomical sums for projections on US Budget Deficits through bailouts now leave the US\$ in a precarious position. If the current weakening in the US\$ continues and parallels the now weakening T-Bond market and if the US\$9 trillion in cash thinks 0.5% is not enough to cover the inflation risk, then a flood of global money is likely to flow out of US\$ cash and T-Bonds. Where will it go? Back into stocks and other major currencies. And gold. And probably other commodities.

We can't comment on US GDP figures and forecasts but we can follow the money flows. The picture for the US does not look pretty just now but from this perspective the resource sector should be a major recipient of funds looking for a home. And it has already started!



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Barry's expertise in the resource investment sector is based on his knowledge from his original career as a geologist and over 30 years' experience in the resources investment sector. Prior to founding MPS in 2000 Barry had worked in senior executive roles of investment management with BT Australia, equities research for Bain Deutsche Bank and equities research and corporate finance for Macquarie Bank. He is also currently a Director of ASX listed Uranium Exploration Australia Ltd, of Superior Coal Ltd, of several investment companies and of a number of unlisted public operating companies. He has also arranged development finance for many listed resource companies.

Well known and well respected for his experience and understanding of the resources sector, Barry is regularly asked to speak at conferences and seminars, write articles and editorials for finance and resource focused newspapers and magazines and also presents video interviews through You Tube and MPSTV.

DISCLAIMER

General Securities – Advice Warning

The purpose of this commentary is to give an insight into the MPS view of the Australian resources and energy market. Reasonable care has been taken to achieve and maintain unbiased objectivity while assessing publically disclosed information.

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